CPI's North America Column Presents:

Consumer Welfare On Trial at the FTC

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November 2018

CPI COMPETITION POLICY INTERNATIONAL

On November 1st, the FTC held its public hearing on the consumer welfare standard, putting the philosophical gulf between critics of the antitrust status quo and its insider practitioners on full display.

By now, the debate follows similar lines: critics of the status quo air their grievances about the state of antitrust law and its enforcement, following decades of conservatizing court opinions and enforcement agencies chastened into weakly enforcing an ever-weaker body of law. Then the insiders strike back with a series of straw man arguments: that the critics want antitrust to solve all of society's problems, that they misunderstand and mischaracterize what the consumer welfare standard is and what function it serves in contemporary antitrust enforcement, that they want every antitrust case to be a fishing expedition for anything that any of a would-be defendant's counterparties might not like about their competition, that it invites "political" interference in law enforcement for the purpose of punishing enemies, and that the critics seek a return to a past "pre-economic" era replete with wrongly-decided cases that impaired economic efficiency and themselves constituted anti-competitive restraints.

Defenders of the status quo argue that the "true" consumer welfare standard does not have any of the flaws by which critics indict the status quo—the "true" consumer welfare standard can easily dispatch with labor market monopsony, for example. The "true" consumer welfare standard doesn't insist on evidence of price increases and it doesn't exempt tech platforms that charge zero prices from any antitrust liability.

Unfortunately, the "true" consumer welfare standard is, economically speaking, nonsense. A new working paper by Professor Mark Glick, "The Unsound Theory Behind the Consumer (and Total) Welfare Goal in Antitrust," makes this point crystal clear: as a metric for social welfare, the economic concept of consumer surplus in a market can't possibly work. It requires the aggregability of consumers' cardinal utility functions, and that is an empirically untenable restriction.

Moreover, it weighs the welfare of consumers against greater "efficiency" caused by reduced costs to producers. This is best seen in the horizontal merger context, where the whole enforcement goal is to predict price effects given output market characteristics and weigh them against those "efficiencies." Even if producer surplus is ruled out of our aggregate welfare calculation (and even if we accept the restrictions that make consumer surplus a tenable measure of aggregate welfare), we still have a policy that rewards monopsonists for using their market power to reduce costs and increase markups, so long as prices for consumers don't rise. That tradeoff has typically been justified by the assumption that input markets are perfectly competitive, but a spate of recent research on labor market monopsony makes it clear we can no longer support that assumption as factual.

Incidentally, in a previous FTC hearing on labor market monopsony, Professor Nancy Rose claimed that the subfield of Industrial Organization typically assumes individual firms face upward-sloping labor supply curves—i.e., that they possess wage-setting power in labor markets, rather than hiring from a perfectly competitive labor market taking the wage as given.

In fact, the consumer welfare standard is premised on the opposite assumption, as Glick's paper makes clear in its discussion of horizontal mergers. A recent IO theory paper by José Azar and Xavier Vives relaxes that assumption, modeling competition policy in the event of market power in both input and output markets. In order to speak to issues of monopsony power, more research taking that possibility seriously (as both an empirical phenomenon to be investigated and a theoretical possibility to be modeled) is absolutely necessary.

But the point of these FTC hearings isn't to investigate how the economy works and thus inform antitrust policy-makers. That was revealed starkly at the consumer welfare standard hearing by Jonathan Nuechterlein's presentation of his paper comparing the theoretical antitrust case against Amazon to the actual antitrust cases brought by the Justice Department against the A&P, the then-dominant grocery retailer, in the late 1940s. According to Nuechterlein, those cases were misguided and represented "uneconomic" thinking because the A&P was an innovative company that reduced rents accruing to wholesalers and put inefficient retailers out of business to the benefit of consumers, just like Amazon supposedly does now. According to Nuechterlein, even at the time, economists disdained the A&P prosecution as uneconomic.

Nuechterlein's selective history ignores the robust debate among contemporaneous economists as to whether the government's case was misconceived and whether the remedies it obtained were suited to the harm (if any) the A&P actually did to competition. As Joel Dirlam and Alfred Kahn wrote in their 1954 book *Fair Competition: The Law and Economics of Antitrust Policy,*

> The critics of the A&P decisions have either assumed or argued explicitly that the concessions which A&P was able to extract from its suppliers [reduced exploitation of the consumer]… But because their argument is almost wholly theoretical, it can never prove more than that a big buyer *may* make competition more effective. They have made very little effort to show that in fact the conditions necessary to produce this on-balance beneficial result were actually present.

The exact same critique could be leveled at Nuechterlein regarding both A&P and Amazon.

It was interesting to hear him venerate Amazon as inimical to the interests of small retailers charging high prices (in a paper that its author acknowledged had been funded by Amazon itself)—knowing that frame would appeal to an antitrust audience—when Amazon's presentation of its business model elsewhere consists of playing up its platform as a way for small businesses to reach a wider customer base. Of course, the tech platforms' chameleon-like quality when presenting their business models to different government regulators in order to escape all forms of regulation is well-known.

The debate over the consumer welfare standard proxies for larger questions about political accountability in policy-making and elite versus democratic legitimacy. Unusually, those questions were discussed overtly at the consumer welfare standard hearing. For example, Jonathan Sallet opened by recalling the initial Progressive condemnation of the Supreme Court's *Standard Oil* decision in 1911, because while it agreed to break up the company as a remedy for its violation of Section 2 of the Sherman Act, it affirmed the Rule of Reason—which critics then took to be a judicial takeover of law enforcement destined to find "economic" excuses for criminal conduct. As a result, Congress passed the Clayton Act, enumerating specific acts which themselves constitute grounds for inferring illegal monopolization. Sallet characterized this balance as "enforcers should be granular; Congress should be broad."

On the other hand, the leading Progressive antitruster, Louis Brandeis, came to agree that courts could not avoid the Rule of Reason. Sallet pointed to the 1918 case *Chicago Board of Trade v. United States*, in which Brandeis agreed with the Board of Trade that its rule setting a minimum price for after-hours trading was in fact pro-competitive because in that circumstance, price-fixing protected the competitive process even if on its face it appeared to harm consumers.

Under the Rule of Reason, courts are called on to weigh costs and benefits, and this has the potential to create a procedural and substantive muddle with multiple avenues for defendants to escape liability. Sallet claimed that the consumer welfare standard has exposed these flaws in the Rule of Reason. Tim Wu likened it to a sporting event where the referees are called upon to opine whether individual rule infractions serve some larger purpose with respect to the interests of the fans. A functional legal regime, on the other hand, has rules and assesses liability when those rules are violated, with the rulebook as a whole assumed to be in service to the fans (because, in the case of antitrust, their representatives voted on it) not each individual ruling.

But in recent decades, antitrust enforcers have been constrained only by the fear that an over-powerful federal judiciary would slap them down if they stick their heads too far above the parapet. Thus, better not to test the limits of their authority, lest the judiciary take the opportunity to clip their wings still further. This dynamic of living in fear of a doctrinaire pro-defendant ruling with high precedential value in turn leads agencies not to bring cases that risk one, further confining the scope of legal liability. This is the structural imbalance that results from an excessively narrow set of stakeholders in the antitrust debate. In a healthy policy regime, the judiciary would fear that it would in turn be over-ridden by Congress for ignoring its intent in legislating in the first place, but for too long that threat has been off the table, and in its absence the judiciary has been entirely unconstrained in re-writing the law to conform with its own right-wing ideology.

At the hearing, Professor Carl Shapiro rightly pointed out that the judiciary has been wholly inattentive to empirical economic reality, as opposed to cherry-picked pro-defendant theories, but he also claimed that contemporary antitrust is no longer the Borkian nightmare its critics paint it as. While it is true that the pendulum has swung back from the extremes that characterized agency policy in the 80s, the courts are in fact just as Borkian as they ever were—indeed, perhaps more so, given the reasoning evident in *Ohio v. American Express*, which heightened the barriers to proving liability in the case of "two-sided platforms" by appealing to the consumer welfare standard as a justification for ruling that harm to merchants, in their dealings with credit card companies, is *not* harm to competition if harm to consumers (in the form of reduced output) is not shown. If that is what the consumer welfare standard means, then there is no way that it can be maintained as part of an effective competition policy.

Asked at the hearing what Supreme Court antitrust case needed to be overturned, Geoff Manne, head of the International Center for Law and Economics, said *Chevron*, referring to the 1984 case that established judicial deference to federal regulatory agencies to interpret their legislative mandates. Of course, *Chevron* is not an antitrust case, but Manne's response suggests a concern that renewed political and democratic interest in antitrust might result in an active, rather than passive, enforcer for the first time in a long time. The implication of Manne's naming *Chevron* is that democratically-accountable organs of government cannot be permitted to exercise power if they do so in ways that threaten the consumer welfare orthodoxy. Instead, the judiciary must reserve all authority to itself. In effect, this reasoning implies, as does the whole history of judicial activism on this issue, that antitrust policy is too important to be entrusted to democracy, and whatever economic theory can be rustled up at any given time as justification for overturning and eroding antitrust liability can be pressed into service for that purpose. That is where the consumer welfare standard comes from, that is what it is, and that is why it cannot be permitted to continue to constrain the enforcement of a body of law that could not, in the current economic circumstances, be more necessary.

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